

Massachusetts Bankers Association

March 10, 2004

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, DC 20551

Re: Comments to Proposed Amendments to Regulation CC
Docket Number: R-1176

Dear Ms. Johnson:

On behalf of the 220 commercial, savings and co-operative bank and federal savings institutions of the Massachusetts Bankers Association located throughout Massachusetts and New England; we appreciate the opportunity to comment on the Federal Reserve Board's proposed amendments to Regulation CC which would implement the Check Clearing for the 21st Century Act. We commend the Board's effort to facilitate prompt payment and create efficiencies in the check payment processing system. We support many of the provisions in the proposal, but would like to address a few areas of concern.

1. Substitute Checks

Section 229.2(zz) (definition of substitute check) provides that a reconverting bank may correct an amount encoding error and should correct a MICR-read error from the original check. The Proposal provides that the failure to correct the amount on the MICR field of the substitute check does not affect the status of the substitute check as the legal equivalent to the original check. We agree with this provision,

Section 229.51(c) of the Proposal provides that if a bank transfers and receives consideration for an item that meets all the requirements of a substitute check except for the MICR line requirement in Section 229.2(zz)(2), that item is a substitute check for purposes of the expedited recredit, indemnity and warranty provision of the regulation. However, Section 229.51(2)(c) provides that a substitute check that does not have the correct routing and transit number would not be substitute check under the Check 21 Act and is not a legal equivalent of the original check, but would be subject to the warranties, indemnities and recredit rights applicable to substitute checks.

The Association believes that? even if the MICR line on the substitute check does not accurately represent the MICR line on the original check, the substitute check should still qualify as the legal equivalent of the original check. Under this approach, the MICR line of the substitute check could vary from the MICR line of the original check and transit fields, or in any other field. In all cases, provided the reconverting bank places in MICR line on the substitute check in MICR ink, the substitute check retains its legal equivalence to the original check. We believe this approach is necessary to instill confidence in the parties' processing and receiving substitute checks that they are the legal equivalent of the original check. Banks in the check collection process need to know that they can process a substitute check and treat it as the original check. In most cases, a collecting bank will not know that there is an error in the MICR line of a substitute

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reconverting bank, and the collecting **bank** will transfer that check to a subsequent collecting bank or to the paying bank.

The final rules should permit a bank repair ~~any~~ portion of a MICR line on a substitute check that it receives in the check collection process but should not be obligated to **do** so. We believe that ~~any rules under the Check 21 Act for repair of substitute checks should be designed to encourage banks to treat substitute checks in the same manner as original paper checks. A substitute check that is repaired should not lose its status as the legal equivalent to the original check, regardless of type of repair (full or partial) and regardless of the accuracy of repair. Rather, the collecting bank or paying bank that repairs a substitute check in a manner that results in an inaccurate MICR line information would breach the encoding warranties under the UCC and Regulation CC.~~

We also request the final rule include an a new provision that expressly authorizes a paying bank to create a legally equivalent substitute check without printing the MICR line information in **MICR ink**. Massachusetts General Laws, Chapter 167D section 27, provides that *“any **bank or federally-chartered bank which accepts deposits for demand deposit or other accounts subject to withdrawal by negotiable or transferable instrument for the purpose of making transfers to third parties shall, if requested by the depositor, return the cancelled negotiable or transferable instruments of such accounts.**”* The provision would provide some relief to Massachusetts and New York banks that face a similar burden to return original checks to customers.

Substitute checks that are **paid and canceled** by the paying bank, and are **being delivered** by the paying bank to its drawer customers, should not **be required to be printed in MICR ink**. In these cases the **expense associated with using MICR ink to create this class of substitute checks is unnecessary**. Customers will not in any way be harmed by receiving a non-MICR ink substitute check or be able to determine whether substitute check lacks MICR ink.

2. Delivery of Notice at Time of Consumer Request for Copy of Check

Section 229.57(b)(2) of the Proposal provides **two** alternatives for a financial institution to provide the disclosure notice requirements after the consumer requests a copy of the check. They are: (1) at time of request for original or copy of check, or (2) at the **time** the bank provides substitute check.

The first alternative, delivery at the time the request is made, raises some operational difficulties since a bank may not **know** it would be providing a copy of a substitute check until after the request until after the request has been made by the consumer.

We support the second alternative for delivery ~~of~~ the notice at the time the financial institution provides the substitute check as it offers additional flexibility to financial institutions and does not undercut the value of the disclosure to the consumer. In all cases the consumer receives education notice either before or at the time the substitute check is received. We also request that the final rule permit the financial institution the time the submit check is delivered to the consumer.

3. Model Consumer Educational Document

We believe that the model disclosure for the consumer education document included in the Proposal is too long and detailed. The Check 21 Act requires a bank to provide a “brief notice” regarding the consumer credit rights and the legal equivalency of the substitute check. We recommend that the model disclosure simply define **and** describe a substitute check, explain that

consumers may have certain rights under the federal and state check laws, and they should contact their financial institution if they reiteration of the expedited recredit rights that is too long and complicated. **Consumers** are not likely to read long disclosures and may be unnecessarily confused by the complexity of the proposed model disclosure.

4. Other Model Documents

The Proposal includes a number of other model disclosures that financial institutions may use to satisfy various notice and disclosures requirements under the Act. We believe that these notices **are** helpful to the financial services industry, and will provide useful uniformity to the notices. We also recommend that the final **rule** endorse the use of notices other than the model disclosures and state that in the view of the Federal Reserve, such notices would constitute compliance **with** the Act.

5. Recredit of Interest on Invalid Claims

The Board's proposal under Section 229(c)(4) requests comments on whether the interest should be reversed if recredit is **reversed** in the event of an invalid claim. This **is** particularly important since Check 21 does not explicitly address the reversal of interest when reversing a credit. We do not believe that consumers should benefit from an invalid claim.

6. Indorsements on the Front of Checks

The Board requests comments on whether it should provide returning banks with the flexibility to indorse on the front of the check and include additional information with their indorsements. We anticipate that there will be problems with this approach because it may make it harder **to** detect forgery and interfere with fraud prevention tools.

7. Public Education

Although not addressed in the proposal, we would request **that** the Board offer assistance in educating the public about the change in the payment system. For years, bank customers relied on a 2-3 day float before their checks cleared their account. Despite disclosures, consumers may not understand that their financial institution is not responsible for the faster clearing time and possible fees if there are insufficient funds in the account.

Thank you for the opportunity to submit our comments on this proposal.

Sincerely,

Tanya M. Duncan
Director, Housing and Federal Policy

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